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April 8, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
236 Massachusetts Ave., N.E.
Suite 110
Washington, D.C. 20002

***Ex Parte* Presentation in *In re* Nondiscrimination in the Distribution of Interactive Television Services, CS Docket No. 01-7**

Dear Mr. Caton:

Pursuant to Section 1.1206 of the Commission's rules, two copies of this letter are being filed as notice that representatives of Non-MVPD Owned Programming Networks met April 5, 2002, with members of the Media Bureau. A copy of the material distributed during the meeting is also included with each letter. Please date-stamp the third copy and return it to the messenger that delivered this package.

Representing the Media Bureau were Kenneth Ferree, Barbara Esbin, Thomas Horan, Priya Shrinivasan, Michael Lance, Daniel Hodes, Ben Golant, Kiran Duwadi, and Sarah Mahmood. Representing Non-MVPD Owned Programming Networks were Preston Padden, Susan Fox, Robert Lambert, and Eric Haseltine, of The Walt Disney Co.; Julius Genachowski, of USA Networks Inc.; Scott Flick, of Shaw Pittman LLP, on behalf of Univision Communications Inc.; J. Gregory Sidak and Hal Singer, of Criterion Economics LLC; and myself.

Paragraph 54 of the Notice of Inquiry in the above-captioned proceeding designates this proceeding as "permit-but-disclose." During the meeting, the parties explained the economic, technological, and legal bases for ITV nondiscrimination rules. This was a reiteration of the positions that Non-MVPD Owned Programming Networks took in the comment and reply they filed in this proceeding.

Yours truly,

Neil Fried
Paul, Hastings, Janofsky & Walker LLP
Counsel for Non-MVPD Owned
Programming Networks

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List ABCDE

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cc (w/o attach):

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Sarah Mahmood

Nondiscrimination in the Provision of Interactive Television Services

J. Gregory Sidak & Hal J. Singer

CRITERION ECONOMICS, L.L.C.

Forms of Discrimination Against Unaffiliated ITV Providers

- The cable firm can degrade the quality of the interactive portion of a program supplied by an unaffiliated content provider
- The cable firm can refuse to carry the interactive portion of a program supplied by an unaffiliated content provider
- The cable firm can condition carriage of the interactive portion of a program of an unaffiliated content provider upon its payment of an exorbitant rate that is tantamount to a refusal to carry such content

Neo-Chicago Motivations for Discrimination: Case 1

- Market Extension
  - The goal of this form of discrimination is to force the unaffiliated rival to operate below an economically efficient scale.
  - Assuming that at least some consumers wanted *only* the service produced by the rival firm, those consumers would suddenly face a monopolist and they consequently would suffer a harm from reduced competition.

Neo-Chicago Motivations for Discrimination: Case 2

- Market Preservation
  - The goal of this form of discrimination is to keep the unaffiliated rival initially small in its production of the upstream product.
  - In future periods, the unaffiliated rival is not an effective supplier of that product to competitors of the vertically integrated firm in the market for the downstream product.

Necessary Conditions for Discrimination to Harm Consumers

- Market Discrimination
  - Scale economies in the production of the upstream good
  - At least some customers do not perceive the downstream good to be a complement to the upstream good (“island natives”)
- Market Preservation
  - Network effects in the consumption of the upstream good
  - The possibility that the unaffiliated upstream provider might eventually compete directly or indirectly in the downstream market.

Are the Conditions for Market Extension Satisfied?

- Scale Economies
  - Most of the production costs of interactive content, like the production costs of non-interactive programming content, are up-front sunk costs
- Island Natives
  - For the 20 percent of MVPD customers *inside* the cable firm's territory who subscribe to DBS service and for all MVPD customers *outside* the cable firm's territory, non-cable affiliated programming is not perceived to be a complement to the cable conduit.

Are the Conditions for Market Preservation Satisfied?

- Network Effects
  - The desirability to a consumer of a particular variant of interactive content will depend on how many other consumers view that variant.
- Future Downstream Competition
  - To the extent that content discrimination by cable firms could drive out unaffiliated content providers, DBS providers would become more dependent on cable firms to supply both interactive and non-interactive content.

Private Tradeoffs Involved in the Decision to Discriminate

- Costs of Discriminating
  - Lost in-region access sales for the vertically integrated cable MSO.
- Benefits of Discriminating
  - Greater content and advertising sales across the nation
- *Conclusion*: If the benefits of discriminating exceed the costs, then the vertically integrated cable operator has an incentive to discriminate

Policy Considerations (1 of 2)

- The Commission should not treat the advent of interactive content differently from any other content innovation.
  - The *failure* to impose nondiscrimination protections would actually decrease investment in interactive programming by unaffiliated content providers.
- Encouraging competition in the intermediate "ITV platform market" would not alleviate the bottleneck at the conduit level

Policy Considerations (2 of 2)

- Unaffiliated ITV content provider is *not* seeking to obtain capacity in the cable pipeline at a wholesale rate only to resell it to end users at retail prices.
  - Instead, the Non-MVPD-Owned Programming Networks are seeking protections for a portion of their signal—namely, the interactive portion—that is *already* carried by cable firms.
- For industries that are subject to network effects, the stakes are extremely high in the early stages because markets may tip quickly.
  - Delay under such circumstances can readily make the regulatory response too late to be meaningful.